FILE COPY

IN THE

SUPREME COURT OF THE UNITED STATES

October Term, A. D. 1946.

No. 1206

FRANCIS S. CLAMITZ,
Petitioner,

vs.

THATCHER MANUFACTURING COMPANY, a corporation, and WALKERMAN D. DUGAN, JERVIS LANGDON, WILLIAM H. MANDEVILLE, RAY W. NIVER, FRANKLIN B. POLLOCK, FREDERICK W. SWAN and S. G. H. TURNER,
Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT AND BRIEF IN SUPPORT THEREOF.

Meyer Abrams,
Joseph Nemerov,
Maurice J. Dix,
Attorneys for Petitioner.

Shulman, Shulman and Abrams,
134 North LaSalle Street,
Chicago, Illinois,
Of Counsel.

Midwest Law Printing Co., 340 W. Huron St., Chicago

INDEX.

Summary of Argument.

I.

Cases Cited.

Other Authorities Cited.

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, A. D. 1946.

No.

FRANCIS S. CLAMITZ,

Petitioner,

vs.

THATCHER MANUFACTURING COMPANY, a corporation, and WALKERMAN D. DUGAN, JERVIS LANGDON, WILLIAM H. MANDEVILLE, RAY W. NIVER, FRANKLIN B. POLLOCK, FREDERICK W. SWAN and S. G. H. TURNER,

Respondents.

PETITION FOR WRIT OF CERTIORARI.

To the Honorable Chief Justice and Associate Justices Of the Supreme Court of the United States:

Petitioner, Francis S. Clamitz, petitions for the issuance of a writ of certiorari to review the judgment of the United States Circuit Court of Appeals for the Second Circuit, rendered January 8, 1947.

Statement of the Matter Involved.

Petitioner, Francis S. Clamitz, a stockholder of the Thatcher Manufacturing Company (hereinafter called "Thatcher"), filed a derivative suit against the corpora-

tion and its officers and directors, seeking the cancellation of common stock issued to officers and directors under option agreements to sell them stock at $10.00 per share which was then selling on the Stock Exchange at $19.00 per share; and to hold them liable for losses caused to the corporation, and for other relief. The trial court at first held that the granting of the options was illegal, but later changed its mind and held it legal. The United States Circuit Court of Appeals for the Second Circuit affirmed the decision on the ground that while the granting of options at half the price at which the stock was selling on the Exchange would ordinarily constitute fraud, there were exceptional circumstances here which justified the act.

The Questions Presented.

The following questions are presented for the consideration of the Court:

1. Was it lawful to grant unrestricted options to officers and directors to purchase the common stock of the corporation for about one-half the amount at which the stock was selling on the Stock Exchange whereby the optionees were able to speculate and trade in the stock and to profit therefrom without regard to their employment.

2. Was it proper to receive and consider the evidence in justification of the granting of the options in the absence of such a defense, and whether after holding as a matter of law that it was fraudulent to grant the options it was nevertheless proper to grant them because of the defense, which was not pleaded.

3. Whether the directors had the power to release, and whether they acted in good faith when they released the president and director from his liability to the corpora-

tion for a profit of $8.00 per share on the 2468 shares which he sold at $18.00 after he exercised his option to purchase the shares of the corporation at $10.00.

Specification of Errors.

1. The Court below erred in holding that the taint of fraud, in granting options at $10.00 per share when the stock was selling on the Stock Exchange at $19.00 per share, was removed because of evidence that promises to "key" men were made and that the directors had a right to fulfill their previous commitments within their sound judgment although the optionees could not have compelled them legally to grant the option, and it was its duty to hold:

   (a) That the evidence was inadmissible because of the hearsay rule.

   (b) Even if the evidence was admissible, it was improper to consider in the absence of the affirmative defense of justification.

   (c) The determination that the granting of options at half the price at which the stock was selling at the Exchange was a fraud on the corporation in the absence of "something else" should have led to the reversal of at least the judgment as to the liability of the defendants for the 1500 shares which Dugan obtained at $10.00 per share as it was conceded that the "something else" did not apply as to him.

2. It was the duty of the Court to hold that the reclassification of the shares for the option purpose was procured by fraudulent means and it clearly erred when it sustained the judgment of the trial court.

3. It was the duty of the court to hold that the granting of the options was unlawful and that the stock issued to the officers and directors be surrendered for cancellation.

Reasons for the Granting of the Writ.

1. The case presents important questions in corporation law involving fiduciary obligations of officers and directors. The growth of corporations and the disappearance of individual and partnership forms of business have become so extensive and vital in our economic life, and so many artificial legal devices have been set up which serve to isolate the stockholder from control over his investment, that directors and other officers of a corporation should be held to strict accountability for their acts when they deal with trust assets for their personal gain, and the opinion is in conflict with the decision of the Sixth Circuit whose views are completely different from the views expressed in this opinion (*Ashman* v. *Miller*, 101 F. (2) 85, 91).

2. There is directly involved the construction of rule 8(c), requiring the defendant to plead specially matters in avoidance or justification, and its effect on the admissibility and the consideration of the evidence, and the decision nullifies the purpose of the Rule and is in conflict with the decision of the First Circuit (*Schmidtke* v. *Conesea*, 141 F. (2) 634, 635).

3. The affirmance of the judgment of the trial court that the directors had the power and acted in good faith when they released the president and director from his admitted liability for the profit of $8 per share on the 2468 shares which he sold in March, 1944 is in conflict with the decision of the Fifth Circuit (*Hurt* v. *Cotton States Fertilizer Co.*, 159 F. (2) 52, 58).

4. The decision to the effect that options to purchase stock may be granted to officers and directors without fixing the value of the stock and without restricting the right to transfer the stock conditioned on the term of em-

ployment is in conflict with two well reasoned decisions by the District Court of Pennsylvania.

5. The question whether directors may grant stock options to "insiders" at one-half of the price at which the stock was selling on the Stock Exchange because of alleged commitments before the advance of the sale price on the Exchange is of extreme importance in the field of corporation law. The opinion may be used as a license to grant options to "insiders" in anticipation of, advancement of sale price on the Exchange and to justify the acts on alleged *ex parte* promises which cannot be refuted.

6. The decision to the effect that directors of a corporation who were not legally bound to execute the options and which would have otherwise constituted fraud or a waste of the corporate property, may, nevertheless, grant the option because of alleged commitments, including the options for 1,500 shares to Dugan, to whom no commitment was made, is so fundamentally erroneous as to require a review by this Court.

7. The United States Circuit Court of Appeals for the Second Circuit has decided important questions in the field of corporate law and trusts in conflict with fundamental law, and the questions are of great public interest. The decision has so far departed from the accepted and usual course of judicial proceedings and has so sanctioned such a departure in the lower court as to call for the exercise of this Court's power of supervision.

Prayer for Relief.

Wherefore, petitioner, Francis S. Clamitz, plaintiff below, prays that the prayer for writ of certiorari may be granted and that this Court proceed as provided by law and the rules of this Court in such cases, and that

upon final hearing the judgment of the United States Circuit Court of Appeals for the Second Circuit be reversed with directions to reverse the judgment below and to direct the entry of a decree in favor of the plaintiff, the petitioner herein.

Respectfully submitted,

MEYER ABRAMS,
JOSEPH NEMEROV,
MAURICE J. DIX,
Attorneys for Petitioner.

SHULMAN, SHULMAN & ABRAMS,
134 North LaSalle Street,
Chicago, Illinois,
Of Counsel.

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, A. D. 1946.

No.

FRANCIS S. CLAMITZ,

Petitioner,

vs.

THATCHER MANUFACTURING COMPANY, a corporation, and WALKERMAN D. DUGAN, JERVIS LANGDON, WILLIAM H. MANDEVILLE, RAY W. NIVER, FRANKLIN B. POLLOCK, FREDERICK W. SWAN and S. G. H. TURNER,

Respondents.

BRIEF IN SUPPORT OF PETITION.

Jurisdiction Invoked.

The decision of the United States Circuit Court of Appeals for the Second Circuit sustaining the judgment below was rendered on January 8, 1947. The petition is, therefore, filed timely, and the jurisdiction of this Court is invoked under Judicial Code, Section 240 (a), 28 U. S. C. A., Section 347 (a) as amended by the act of February 13, 1925.

Opinion Below.

The opinion of the District Court is not reported and is printed in the record at pages 82 to 93. The opinion

of the United States Circuit Court of Appeals for the Second Circuit (R. 113-127) is officially reported (158 F. (2) 687).

A STATEMENT OF THE CASE.

Scheme to Control:

Franklin B. Pollock was a vice-president of Olean Glass Company, a subsidiary of the "Thatcher". He was employed at a salary of $25,000 per year plus commission (R. 39). While in such employment he and his associates devised a scheme to capture control of "Thatcher" (R. 96). They accumulated over 30,000 shares of the common stock between July and December, 1943 at prices ranging between $6 and $9 per share (R. 39, 43, 50). He appeared at the meeting of the Board on December 15, 1943 and told them (R. 53) that he and his associates had purchased a "working control" of "over 20%" of the common stock, which did "not begin to approximate" the "present position," and that they proposed "to expand this position regardless of the results of this meeting." He demanded to be elected president, director, and "chief" executive officer, and that the Board should, at its next meeting, "remove" officers and "elect" other officers he would recommend. He also requested that every assistance be extended to him in carrying out his program which included the injection of some "new blood", "the delegation of authority" and a stock option program "for key executives." (R. 169-171)

Acquisition of Control:

The Board immediately surrendered the control of the corporation to Pollock. Ackerman resigned as president and was made chairman of the Board. Pollock was

elected as a director and president. All of the other officers were requested to tender their resignations, which were delivered to Pollock (R. 170). One week later, on December 22, 1943, Pollock presented the resignations of all of the officers (R. 175) which were immediately accepted. All of the officers and their salaries as recommended by Pollock were accepted. The "one week" chairman of the Board, Ackerman, resigned and "left the meeting." Whitney S. Powers became secretary-treasurer at an annual salary of $12,000. F. W. Rodewald, one of the "new blood," became vice-president at a salary of $18,000 per year. Putnam Neil became vice-president at a salary of $12,000 per year. W. D. Dugan was elected vice-president at a salary of $18,000 per year. W. H. Mandeville was elected as vice-president at a salary of $12,000 per year (R. 176). Pollock then asked for the immediate termination of his contract of December, 1941 under which he said that he was then receiving "in the neighborhood of $80,000 per year" and the substitution in lieu thereof, of a contract at $50,000 per year for the period of five years with an option to purchase 5,000 shares at $10.00 per share, to be exercised on or before February 1, 1944; 4,000 at $15.00 per share; and 5,000 at $20.00 per share to be exercised at any time on or before January 1, 1949, the company to advance 80% of the purchase price of the stock which was to be held as collateral (R. 177). In fact, Pollock never received $80,000 per year under his existing contract. He received $25,000 per year as a salary plus commission (R. 39). In 1942 he received a total of $55,000 and in 1943 he received $75,000 (R. 39). The entire program of Pollock was accepted unanimously by the Board.

The Other Options:

At the same meeting, when Pollock received his options, the Board also granted at Pollock's recommendation, op-

tions to Rodewald, Dugan, Dusterdieck, and Powers for 3,500 shares at $10.00 per share. The officers of the corporation were authorized to prepare the stock options and to carry out the program of the new president, which he had prepared in advance of the meeting (R. 178). At a subsequent meeting of January 19, 1944, it developed that there were no shares available for the options, and it was necessary to reclassify the shares, requiring the consent of the stockholders. The Board decided to hold up the stock options until such reclassification was approved by the stockholders (R. 180 181).

The President's Letter:

On February 8, 1944 the "management" solicited proxies in connection with the annual meeting of March 2, 1944, to put over the program. Pollock's personal letter stated that as the "largest individual shareholder" and "chief" executive, he gave a great deal of thought to developing the full earning potentialities of the company and as part of the program he regarded as essential that means be provided to facilitate the acquiring of stock by officers in order to give them an "incentive" to work for the welfare of the company. He informed them that the reclassification of the stock was necessary in order to make such stock available for such program and urged the stockholders to vote in favor of the provision (R. 136). The corporation paid $2,698.47 for such solicitation.

The Proxy Statement:

Neither the letter of Pollock nor the proxy statement informed the stockholders of the "working control" of "over 20% of the stock" by means of which Pollock gained the presidency, the resignations of the officers, and the election of the new officers. On the contrary, it

stated that Pollock only owned 7,668 shares and in addition thereto members of his family owned 3,000 shares, and that no person owned more than 10% of the stock (R. 139). It did not disclose that the Board had already granted the options to the other officers at the same price as they were given to Pollock, but stated that the stock would be issued when sold to such officers as the Board "would" determine (R. 141).

The 1944 Meeting:

Plaintiff addressed a communication to the defendants dated February 16, 1944 (R. 6) requesting to delay the annual meeting in order to afford him the opportunity to communicate with the stockholders in opposition to the program. He was informed that the matter would be taken up at the meeting. The defendants used the proxies to defeat the motion to adjourn, and adopted the program on March 7, 1944. Plaintiff notified the defendants that he considered the meeting illegal and called their attention to the fact that the market quotation of the stock was $19 per share and that they had no right to give options at $10.00 per share. He demanded that Thatcher take proper action to prevent the granting of the options (R. 23). This demand was not even considered by the Board (R. 35). Pollock received the letter, and instead of presenting it to the Board he turned it over to the legal department and proceeded with his program to grant the options (R. 44).

The Option Contracts:

The defendants, who ignored plaintiff's protest, entered, thereafter, into contracts with the optionees on March 22, 1944, granting them the options to the stock, at $10.00 per share (R. 143). On that date, the market

quotation was $19.00 per share (R. 100). The optionees had the right to immediately exercise all of the options and receive the stock at $10.00 per share and to sell them. The exercise of the options was not conditioned on the employment term and the options could have been exercised on any day and the optionees, except Pollock, could have terminated their employment immediately.

The Exercise of the Options:

On March 11, 1944, prior to the execution of the contracts and after receiving plaintiff's protest, Pollock addressed letters to each of the optionees advising them that the options were available. They exercised the options (R. 40) during the period between March 13, and 15, 1944, for the $10.00 per share when the market quotation was over $18.00 per share, prior to the execution of the contracts. While Pollock said that he did not exercise his options until March 31, 1945 (R. 41), his agreement of May 15, 1944 (R. 148) stated that "Pollock did elect to exercise" his option for 5,000 shares at $10.00 per share. He also signed and filed a registration statement on March 22, 1944 with the Securities and Exchange Commission wherein he stated that all of the $10.00 options were exercised, including his own option (R. 179). He filed another statement with the Stock Exchange on March 22, 1944, which stated that all of the $10.00 options were exercised (R. 178).

The Market Speculations:

Pollock represented to the stockholders in his letter of February 8, 1944 (R. 135-137) that he regarded "as essential" that "means be provided to facilitate the acquisition of stock by officers" as he was "a strong believer in key executives having their own money invested

in the company." While the exercise of the options was actually arranged on March 11, 1944, Pollock received his contract on March 22, 1944, under which he had the option to immediately receive 5,000 shares at $10.00 per share, the shares then being quoted in the market at $19.00. He sold 168 shares on the same day, and sold an additional 100 shares a day after, at $19.00 per share. He received $44,913.50 for 2,168 shares (R. 40) which he purchased between July and December at prices ranging from $6.00 to $9.00 per share.

On May 15, 1944, the Board adopted a resolution to release Pollock from a liability to the corporation for the difference between the $19.00 per share which he received on 2,468 shares and the $10.00 option price which he had exercised at the same time under his option contracts. The Board of Directors stated in its resolution that Pollock was liable to the corporation for the profit, but it was not the intention to "penalize" him when they decided to grant him the options but to "reward" him and because of this, they released him from the obligation and granted him a new contract for options at $15.00 per share which he later exercised (R. 152-155).

Decision of Trial Court:

During the progress of the trial, the court pointed out that the optionees were given a profit of "90 per cent" when they obtained the options (R. 56) and this was "steadily mounting." It pointed out that any arrangements by Pollock prior to contracts of March 22, 1944, were revokable and when the market conditions had so changed as to make the stock double in value, the court was "not so sure that the directors" had the right to complete the arrangement "especially where two of the directors" benefited from the options (R. 58). The court cited the familiar rule (R. 59) that "directors, when they deal with corporations have imposed upon

them the standard above that of the market place" because "they are fiduciaries" and while there might be some explanation as to the options given to the employees for a few hundred shares, when it involved "a director who is getting 1,500 shares" the "burden is on the directors to show that it was right." When Pollock attempted to justify the options because of the arrangements and pledges made prior to the time when he was an officer or director, the court said (R. 60) that this did not apply to "insiders" and to officers and directors because (R. 61) "when a man is a director he is in pretty close with the management and he is getting a large block of stocks, that is a different proposition." The court changed its mind later and held that there was nothing wrong with the granting of the options because it was based on a "moral" duty on promises which were made prior to March 22, 1944 and dismissed the complaint for want of equity (R. 105).*

Decision of Reviewing Court:

The Circuit Court of Appeals in affirming the decision of the District Court (158 F. (2) 687) stated that it would take it for granted that all "else" aside the granting of options at $10.00 when stock was selling in the Exchange for $19.00 would be "so great a spread between price and value that it would amount to a constructive fraud upon the corporation." It justified, however, the transaction in the instant case on the ground that a promise had been made before to the "key" men to grant them the options. In view of its holding that the granting of the options was a constructive fraud it should have at least reversed the judgment below as to the option given to Dugan for 1500 shares to whom no commitments were made.

* This "moral" duty or obligation did not apply to the option given to director Dugan for 1500 shares at $10 per share when the market price was $19 per share and to whom no promises were made (R. 68).

ARGUMENT.

I.

The statement in the opinion that the granting of options at $10.00 on stock selling on the Exchange at $19.00 would be so great a spread between price and value that it would amount to constructive fraud called for a reversal of the judgment below as there was no defense pleaded in justification of the fraud as required under Rule 8 (c).

The opinion states (R. 124) that the court "shall take it for granted" that the granting of options at $10.00 on stock selling on the Exchange at $19.00 *"would be so great a spread between price and value that it would amount to a constructive fraud upon the corporation."* It held, however, that there was something "else" in this case to remove it from the constructive fraud, being that the optionees were led to believe, prior to the granting of the options, that they would receive the options and that "Good morale" would not be attained if those who had been led to expect the options would be disappointed when, because of the delay, the price increased on the Exchange and thereby the promises made to them would not be fulfilled. This is the *only ground* upon which the "constructive fraud" was given a judicial justification. *No such defense was ever pleaded.* This was an *affirmative defense* which was required to be pleaded under Rule 8 (c), and which was not pleaded.*

When the evidence was sought to be introduced, plaintiff objected (R. 65, 67), and it was the duty of the court to sustain the objections. The reception of the evidence,

---

*** The affirmance of the judgment on a defense which was not pleaded and on evidence which was unjustly received over objections, is in conflict with the decision of the First Circuit in Schmidtke v. Conesea, 141 F. (2) 634, 635. The conflict of the decision on the construction of Rule 8 (c) is pointed out 7 F. R. S. page 219.**

even if no objection were interposed, would not have been ground to justify the constructive fraud in the absence of an affirmative defense. Besides, Dugan, a *director* and vice-president, who was given an option for 1500 shares at $10.00 per share (exclusive of his salary of $18,000 per year) *did not receive his option as a condition for his employment* (R. 68) and the justification clearly was inapplicable as to him.

(a) The defense of justification for the fraudulent and wrongful act was not pleaded, and the evidence was improperly admitted and improperly considered.

In *Millard* v. *Millard,* 221 Ill. 86, the general rule of equity was stated by the Illinois Supreme Court as follows (p. 92):

> "In equity the written pleadings must definitely inform the adverse party and the court of the facts relied upon for relief or defense, and the answer must set forth the facts claimed as a defense, so that the complainant may question their legal sufficiency or take issue on the answer. The pleadings must also inform the court of the points of difference between the parties, and neither can mislead the adversary by setting up one ground of action or defense and proving another. A complainant cannot avail himself of any claim established by the proof which has not been alleged in the bill, and *a defendant cannot avail himself of any matter of defense not stated in his answer,* even though it should appear in the evidence. (*Kellogg* v. *Moore,* 97 Ill. 282; *Crone* v. *Crone,* 180 *id.* 599; *Dorman* v. *Dorman,* 187 *id.* 154; *Higgins* v. *Higgins,* 219 *id.* 146)."

This rule *also prevails in the Federal Courts* (*Swift* v. *Coe,* 102 F. (2) 391; *Schmidtke* v. *Conesea,* 141 F. (2) 634, 635; *Sesin* v. *Romadke,* 145 U. S. 29, 50).

The opinion failed to notice that the options were not given only to the employees, but also were given to the directors. This distinction was recognized by the trial judge when he said (R. 59): "While there might be some explanation for going ahead * * * as to the employees * * * when it came to a director who is getting 1500 shares I think that the burden is on the director to show that that was right." * There was no defense interposed that the giving of the options to the directors was right. The trial court also pointed out (R. 60) that the rule as to "insiders" is different, and that when they decided to give the options to the "insiders" they knew what the public did not know, that instead of a deficit of \$.79 per share for the year 1942, the company earned \$.86 per share for the year ending 1943 (R. 43).

(b) The evidence which is the foundation for the defense was clearly inadmissible.

The evidence upon which the defense to relieve the officers from the constructive fraud was based, consisted of conversations between Pollock (before he was even an officer and director of Thatcher) and "key" men whom he was to engage, and was *clearly objectionable on the ground of the Hearsay Rule* and such objection was interposed (R. 65-66). (20 Am. Jur. section 555). The trial court clearly erred when it permitted the evidence to be received, and the Court of Appeals equally erred when it relieved the defendants from liability for the fraud for which it held they would otherwise be held liable. The conversations between Pollock and the "key" men, who were to be employed, were in the absence of the plaintiffs or the other officers of the corporation. How could anyone

---

* The director to whom the court referred was Dugan and it was admitted that his employment was not conditional on the options (R. 68). The burden was therefore not met, and the only theory upon which the Court of Appeals ~~condemned~~ the fraud did not apply to him.

condoned

refute such testimony? If officers of a corporation who commit frauds may be relieved from their frauds because of understakings which they have made *ex parte*, which can never be refuted, *such a practice will serve as a license* for future frauds, without any opportunity to refute the justifications and it is a dangerous policy to announce.

The falsity of the entire story is demonstrated from the fact that Ackerman, with whom no conversation was ever had prior to the adoption of the program to grant the options, was also scheduled for an option (R. 70). Dugan, a vice president and director to whom no commitment was ever made (R. 68) was given an option for 1500 shares at $10 per share. It is conceded by the trial court, as well as by the reviewing court, that there was no binding agreement prior to March 22, 1944 when the contract granting the options was made and when the stock was selling at $19 per share.

The trial court expressed doubt (R. 58) whether the directors may go ahead with the execution of an agreement which was not binding where two of the directors benefited from it, but later approved it because those directors did not vote.* It is true that the formalities of the law were observed. However, a dominating influence may be exercised in other ways than by vote (*Globe Woolens & Co.* v. *Utica Gas & Electric Co.*, 224 N. Y. 483, 488). Here the dominating influence of Pollock is not debatable.

The justification of the constructive fraud on the ground that the officers of the corporation had committed themselves to grant the options, finds no sanction in the

---

* The court of appeals did not sustain the judgment below on ~~their~~ that theory. On the contrary, it held that in the absence of "something else" it would constitute fraud. It overlooked that "something else" did not apply to the two directors.

law. While a natural person may waste his money to fulfill moral obligations, directors who stand in a fiduciary duty may not waste the corporate funds to fulfill their moral commitments (*Bassier* v. *Aetna Explosive Co.*, 246 F. 972, 993).

(c) The reclassification of the stock for the option purposes was procured by fraudulent means and the options were therefore void.

The opinion justifies the otherwise "constructive fraud" on the ground of the alleged promise to the "key" men prior to the advancement of the price on March 22, 1944 and that the carrying out of the promise was "a business problem for the directors to solve." The court overlooked that the directors were in no position to solve this business problem without a prior reclassification of the stock which *required the stockholders to solve the problem*. If the stockholders were informed of the advance promises to the "key" men, and of the danger to the upbuilding of the corporation upon a breach of the promise, then it might be said that the stockholders solved this problem and the directors had the right to carry it out. However, when the stockholders were asked to vote on the reclassification, *the whole subject matter was concealed from them, and they did not exercise this business judgment*. One does not exercise a business judgment when the business is not presented to him. On the contrary, instead of telling the stockholders that promises were made for the 21,000 shares to the other key men besides Pollock at $10 per share, the stockholders were told (R. 141) that the 21,000 shares "would be reserved for sale to optionees" upon such terms as the board "would approve." They were not told that the board had already approved the granting of the options and had

committed itself to the "key" men. The stockholders had the right to assume when they executed their proxies in favor of the reclassification *that the board would not commit a fraud* and would not grant the options at $10 when they were selling on the exchange at $19. Not only were the stockholders not informed of the advance promises made to the directors, but were not even informed of any advance promise that was made.

The proxies were solicited and obtained on the proposition that the officers and directors would borrow 80% from the corporation to pay for the shares. Such solicitation was against public policy (*Ashman* v. *Miller*, 6th Cir. 101 F. (2) 85, 91).* Having procured proxies which were against public policy the use of the proxies for reclassification was illegal, although, thereafter, the officers did not borrow the funds.

The fraud in the procurement of the proxies appears from the fact that the stockholders were informed that no one owned more than 10% of the stock (R. 140). The officers concealed from the stockholders the fact that Pollock controlled over 20% of the stock; that he had a "working control" and because of this working control he became the president and director and received his new contract. Having procured the proxies by concealment of material facts and **having used the corporate funds for the adverse interest of the directors, it must follow that the proxies were void** (*Olson* v. *Rossetter,* 330 Ill. App. 304; *Shapiro* v. *Chicago Title & Trust,* 328 Ill. App. 650; *Rothschild* v. *Jefferson Hotel Co.,* 55 F. Supp. 315), and the reclassification, therefore, which was obtained by the use of the proxies was void and the granting of the options was, therefore, inoperative.

---

* This vitiated the proxy, or power of attorney, and the management was without power to use the proxies to defeat plaintiff's motion for adjournment and to vote for the adoption of the program.

Plaintiff's attorney appeared at the stockholders' meeting and asked for a short delay in order to enable him to obtain opposition proxies. The directors who obtained the proxies by misrepresentation used the very proxies to defeat the adjournment of the meeting (R. 150). Although no opportunity was afforded to the plaintiff to communicate with the other stockholders, it appears that 12,000 *shares were cast in opposition to the reclassification* (R. 152). The majority of the stockholders, even if they had been present in person, would have had no right to give away the property of the corporation at the expense of the minority. Here, the majority voted by proxies, which were obtained by fraudulent means *and for purposes which were against public policy.* The reclassification, therefore, was void and all subsequent acts leading to the granting of the options were fraudulent and void.

II.

The defendants violated their trust in granting the options in the face of plaintiff's warning that they were without power to grant the options.

In considering the justification for the granting of the options which would otherwise constitute fraud, it is necessary to view the entire picture which brought about the granting of the options.

(a) The scheme to obtain control of Thatcher and to grant the options was fraudulent and is without excuse.

This was not a case where a board exercised its independent judgment, but was a case where an employee of the company devised a scheme to obtain control of the corporation which employed him, to oust his superiors,

and to compel the board to surrender its duties to him at the threat of being ousted.

It appears from the findings of the court (R. 96) that between July and December of 1943 Pollock and his associates purchased upwards of 30,000 shares of the common stock for the purpose of enabling Pollock to assume the presidency and the direction of the corporation's affairs. These stocks were purchased at prices ranging between $6 to $9 per share (R. 50). Well knowing that the stockholders were widely scattered, he felt safe that with the acquisition of 20% he would have a "working control". He appeared at the board meeting of December 15, 1943 and told the board (R. 178-180) that unless he would be elected as president and director and would receive the resignations of all of the officers and let him name the new officers and change his contract and grant him the options, he would, by means of his large ownership of the stock, carry out his program, telling them (R. 53) that the acquisition of over 20% of the stock was only a first step and that this did not begin to estimate his potential strength. The president, Mr. Ackerman, after due deliberation, agreed to resign and to create the vacancy for Pollock (R. 77), but was promised a job as Chairman of the board at the same salary of $25,000 per year (R. 130). The board immediately surrendered its discretionary powers, delivered the control of the corporation to Pollock as it more fully appears from the minutes of that meeting. This is a most unusual story where an entire board at the request of a person who was not even an officer had all its officers tender their resignations, elected the person president and director, and "delegated" all of its powers to such person (R. 172).

(b) The options were acquired under false pretenses and none of the optionees were entitled to benefit therefrom.

In his letter of February 8, 1944, to the stockholders, Pollock stated that the options were to be granted as "an additional incentive" to those "who contributed most to the welfare of the company" and (R. 137) that he was "a strong believer in key executives having their own money invested in the company". The only inference that can be drawn from this representation is that the "key" officers were to retain the stock and not speculate with the stock in the market. He had the Board adopt the resolution to grant him the options on December 22, 1943. On March 11, 1944, he addressed a letter to all optionees concerning the granting of the options and asked them to indicate by return mail their intention to exercise their options (R. 163-140). While the contracts for the options were all executed on March 22, 1944, the contracts were a mere formality. The exercise of the options was between March 12 and March 14, 1944, *before* the execution of the option agreements (R. 40). In order for Pollock to exercise his option all that was necessary was to deliver a check to the treasurer of the company (R. 41). When asked by the Court (R. 41): "Did you write yourself a letter inviting yourself to accept the options tendered?", he answered he did not believe he wrote such a letter because he felt a letter was necessary to the other optionees but not to himself. He testified that he exercised his first option in March, 1945 (R. 47). He evidently forgot that in his agreement of May 15, 1944 (R. 175) he stated that under the option of March 22, 1944, which gave him the right to buy *on or before* April 1, 1944, the 5000 shares at $10.00 per share, he *"did elect to exercise"* the option, but "de-

livery" was postponed pending listing with the Securities and Exchange Commission. Having armed himself with options to buy 5000 shares at $10.00 per share, he sold 2168 shares between March 18 and March 23, 1944, at prices ranging from $18.00 to $19.00 per share (R. 40). True, he testified that he sold these shares because he needed to buy a home and these were the *only* shares he sold; it is *curious*, however, that he sold 168 shares on March 22, 1944, the day he received his option at $10.00 per share and he also sold 100 shares at $19.00 per share on March 23, 1944, a day *after* he received the option and after he certified to the Commission and Stock Exchange that he "purchased" these shares under the option! (R. 40). He would not have sold these shares which he purchased in July, 1942, at prices ranging from $6.00 to $9.00 *if he did not have in his possession the option to buy* 5000 *shares at* $10.00 and all he needed was to pay 20% in cash.

The story that he did not speculate in the market but made a single sale because he needed the funds must be completely disregarded because *it is contradicted by the exhibits* and his subsequent testimony. He did not make a single sale, but he sold the stock on *three* dates—March 18, March 22 and March 23, 1944, and another date is undisclosed. If the sale was made because he was pressed for funds, why did he not sell all of the 2168 shares at one time? He did not tell his Board members on March 22, 1944, or prior thereto, that he was selling his stock (R. 32). It must be assumed that the Board would not have granted the options if it knew that the optionee was then selling his own shares at $19.00 per share. The options given without the fixing of the value of the no par value stock and below the market quotations for the purpose of helping Pollock to manipulate the market for

his "personal advantage" were fraudulent and void (*Abrams* v. *Allen*, 36 N. Y. S. (2) 170, 172-173).

The action of the Board of Directors on May 15, 1944 (R. 153) is of great significance in relation to the *good faith* of Pollock and the Board members. Their resolutions involving the options given to Pollock recited that Pollock was given options to buy 5000 shares at $10.00 per share to be exercised on or before April 1, 1944 and he sold during March, 1944, 2468 shares at about $18.00 per share and "thereby would become liable to refund to the Treasury of the company" the profit of $8.00 per share and it was not the intention of the Board "to impose a penalty" upon Pollock, but to "benefit" him and "as a *reward* for services performed" the Board, therefore, resolved to relieve him from the liability and to grant him a new option to purchase 5000 shares at $15.00 per share. They granted him a new option to buy 5000 shares at $15.00 per share and they released him of an obligation to Thatcher of $19,704.*

This action of the Board in view of the representation made to the stockholders in Pollock's letter of February 8, 1944, that the options were given in order that "key executives" should have an investment in the company, was clearly in breach of their trust duties. The stockholders were *not* told that the option was to "benefit" Pollock and to "reward him for services performed". There was no consideration for the release of Pollock's liability for the $8.00 per share on the 2468 shares which the Board stated he was liable to refund to the Treasury. The retroactive "gift" to Pollock of the amounts which were admitted due from him was clearly not within the power of the "Board" or even of the majority stock-

* There was no consideration for this release and the confession of the "Board" that the option was "as a reward for services performed" brings this case within the rule announced in Holthusen v. Budd, 52 F. Supp. 125, 129) and cases there cited holding such options void.

holders (*Hurt* v. *Cotton States Fertilizer Co.,* 159 F. (2) 52, 59). The bad faith of the president and the Board members was, therefore, conclusively demonstrated and the court clearly erred when it held otherwise.

III.

The failure to fix the value of the no par stock was in itself sufficient to declare the options void.

It appears from the minutes that the board did not appraise the value of the no par stock when it determined to grant the options and merely accepted the program outlined by Pollock (R. 42, 43). The testimony of Mandeville that the board did appraise it is not supported by the record and should have been wholly disregarded. While the New York State Corporation Law provides that par value stock may not be sold for less than par (*Sec.* 14 *of the N. Y. S. Corp. Law*), it equally applies to no par value stock which cannot be sold unless at a fair value (*Stone* v. *Young,* 210 App. Div. 303, 309). In the instant case there was no resolution passed fixing the value of the no par value stock prior to the granting of the options and *the options were merely based on the arbitrary figure proposed by Pollock.* The distinction between par value and no par value stock is well pointed out in *Bordell* v. *General Gas & Electric Co.,* 132 Atl. 444, and the conclusion is that before no par value stock may be sold, the directors must fix the consideration for the sale of the no par value stock. *No such resolution and no such action was taken in the instant case.* Granting of an option without fixing the fair value of the stock is not sanctioned under the New York law (*Donovan* v. *Powers Fixtures Products,* 181 N. Y. S. 157, 159).

The granting of the options here, without fixing the value of the stocks, was against public policy and void.

IV.

The options were not conditioned on employment and such options were fraudulent and void.

None of the options were contingent on employment. While there were provisions in the contracts which on the surface connected the options with the employment, there was a "joker" contained therein because under the contracts, the optionee could exercise all of his options on one day and terminate his employment the next day and he would thereby have received all the benefits of his options. In fact, *Dugan exercised his option at* $10 *a share and left his employment thereafter.* Such options are against public policy.

The National Industrial Conference Board, Inc. study of Stock Option Plans in the United States (1928) at page 118 says: "Temptations to resale are numerous for owners of negotiable stock. A number of companies, as already noted have given up selling securities to their employees because they are quickly resold." In selling stock to its employees Hood Rubber Company "requires that the consent of the company be secured in case resale is contemplated." As a result of lack of restrictions, the challenged Thatcher stock option plan is a device to obtain cheap stock for resale at a profit to the optionee with loss and injury to the stockholders. That is neither "rightful" nor "legitimate" and is beyond the scope and purpose *of a lawful stock option* plan.

In *Holthusen* v. *Edward G. Budd Mfg. Co.,* (52 F. Supp. 125) the court cited authorities on the point that if options were given below the actual value, which have no relation to the value of the services for which they are given, that such options are in reality "gifts", and the majority stockholders have no power to give away

corporate property against the protest of the minority. The options, which recite that they were given for past services, are surely void. As said in *Holthusen* v. *Edward G. Budd Mfg. Co., supra,* at page 129: "Moreover, past services of employees to whom options are granted do not constitute consideration for their grant" (Citing many authorities). There, the court particularly distinguished the decision in *Diamond* v. *Davis,* 38 N. Y. S. (2) 103, where the validity of an option was upheld, pointing out that in that case the option was given in good faith and as an incentive to retain the services of the officer, and it stated that it was distinguishable from the case which the court considered because in that case the persons to whom the options were given did not undertake any obligation to continue in the corporation's services for any specified period "contrary to the factual situation in the *Diamond* case". In further distinguishing the *Diamond* case the court said (p. 130):

> "It is the action of the stock market rather than the extent of the services rendered to the defendant which is the factor which will control the exercise of the option. Thus, a sharp rise in the value of the stock in the market to a point above the option price might occur one month, six months, a year, three years, or not at all within the five year period of the option."

This is *apropos* here where it appears that the options were given for speculations in the market. There, the court further said (p. 130):

> "At the very least, conceding for argument's sake that some relationship between the services of the optionees and the market value of the common stock might exist, the absence of any relationship between the length of time an optionee must work and the right to exercise his option renders the grant of the option a disbursement of valuable property of the de-

> fendant without consideration other than the hope of a continuance of the optionee's services for an indeterminate period."

See also the subsequent opinion in *Holthusen* v. *Edward G. Budd Mfg. Co.,* 53 F. Supp. 488, where the option was given under an amendment that fixed the value of the option and restricted its transfer. In the instant case the granting of the options at $10.00 per share when there was no obligation to continue the employment and where the options could have been exercised on one day and the employment could have been terminated the next day the options were clearly fraudulent and illegal.

The provision in the options, granting them in consideration for future services, were also void because there was no agreement on the part of the optionees to continue in the service of the corporation for any definite time, with the exception of the president, who agreed to serve for five yars, but at the date of his contract he still had a contract which did not expire until 1947 and there was no basis upon which the Board of Directors could have determined his salary in view of the speculations in the market and of the market conditions. Stock may not be issued for services to be rendered in the future (*B. & O. Electric Construction Company* v. *Owen,* 176 App. Div. 399, 400). Here the option was given for either past or future services, and it was void and illegal.

In 13 *American Jurisprudence, Section* 178, the author said:

> "No par value stock issued pursuant to a resolution reciting that it is in consideration of services rendered and of services to be rendered, is invalid for lack of consideration where it is not possible to tell from the evidence what proportion of the consideration was services to be rendered, such services not constituting lawful consideration for the issuance of the stock."

The minutes of the "Board" conclusively show that the options were given "for services rendered" (R. 155) and were therefore issued without consideration.

CONCLUSION.

We have demonstrated that this was not a case where a corporation granted options to its employees in order to retain them in its employ. The options were granted because of a scheme worked out between Pollock and others, employees of the company, to oust their superiors through the acquisition of a large block of stock in the market at the lowest price whereby they coerced the Board of Directors, except those who were in the deal, to accept the program and to give the options and the contracts as imposed upon them by Pollock.

We have also shown that none of the options contained the provisions that the stock could not be sold or assigned after the exercise of the options and prior to the termination of the employment; that the options could have been exercised on March 22, 1944, and on the next day the optionee could have terminated his employment (as was the case of Dugan), and that options at $10.00 per share, when the market quotations were $19.00 per share, are not justifiable on any theory. The opinion of the Court of Appeals concedes that this was a constructive fraud, but it erroneously concluded that there was something "else" here which removed the taint of fraud. This conclusion finds no support in law, its effect is fraught with danger. We have also shown that the opinion

is not in harmony with decisions of other circuits. The decision deserves a review by this court and the writ should be awarded.

Respectfully submitted,

MEYER ABRAMS,
JOSEPH NEMEROV,
MAURICE J. DIX,
Attorneys for Petitioner.

SHULMAN, SHULMAN AND ABRAMS,
Of Counsel.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1946

No. 1206

FRANCIS S. CLAMITZ,

Petitioner,

against

THATCHER MANUFACTURING COMPANY, a corporation, and WALKERMAN D. DUGAN, JERVIS LANGDON, WILLIAM H. MANDEVILLE, RAY W. NIVER, FRANKLIN B. POLLOCK, FREDERICK W. SWAN and S. G. H. TURNER,

Respondents.

BRIEF OF RESPONDENTS IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

EDWARD K. HANLON,
15 Broad Street,
New York 5, N. Y.

A. H. HARPENDING,
521 Robinson Building,
Elmira, New York.
Attorneys for Respondents.

APPEAL PRINTING CO., INC., 130 CEDAR ST., NEW YORK, WO 2-3242

TABLE OF CONTENTS AND LIST OF CITATIONS

Cases Cited

Other Authorities Cited

IN THE

Supreme Court of the United States

OCTOBER TERM, 1946

No. 1206

FRANCIS S. CLAMITZ,

Petitioner,

against

THATCHER MANUFACTURING COMPANY, a corporation, and WALKERMAN D. DUGAN, JERVIS LANGDON, WILLIAM H. MANDEVILLE, RAY W. NIVER, FRANKLIN B. POLLOCK, FREDERICK W. SWAN and S. G. H. TURNER,

Respondents.

BRIEF OF RESPONDENTS IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

Statement

The petitioner, the holder of 75 shares of the common stock of the respondent Thatcher Manufacturing Company brought this derivative suit in the District Court of the United States for the Southern District of New York, complaining of two steps taken by the directors of the corporation in conjunction with a new administration of the corporation's affairs, one granting options for the purchase of the corporation's stock to some eighteen officers, directors and employees, and the other with respect to a loan of $2,000,000 for the expansion and improvement of the corporation's plant and equipment (R. 2-14).*

---

* References to pages of the transcript of record are indicated by the letter "R".

At the trial the petitioner stipulated to withdraw his objections to all of the options, except five, and of these five only two were to directors, neither of whom had voted for the options (R. 99-100).

At the conclusion of the trial, the Court (Judge Vincent L. Leibell) rendered an oral opinion dismissing the complaint as to both matters (R. 82-94), and subsequently signed Findings of Fact and Conclusions of Law (R. 95-104), holding as to both matters that the acts of the directors were within their powers in the lawful and legitimate furtherance of the purposes of the corporation, were free from fraud and done in good faith and in the exercise of honest judgment and did not result in any waste of the assets of the corporation.

The petitioner thereupon appealed to the Circuit Court of Appeals for the Second Circuit, bringing up for review merely the granting of the options to the five officers and directors. That court affirmed (158 Fed. 2d, 687) with the comment that there was involved a business problem for the directors to solve, and added (p. 693):

> "Having justifiably found that they did it in the manner heretofore stated by honestly exercising their best judgment to promote the welfare of the corporation the trial court rightly dismissed the plaintiff's complaint whose charges of fraud and waste remained to the end the unproved assertions of but one dissatisfied stockholder".

We respectfully submit that the petition for a writ of certiorari should be denied because

(1) No questions of law are presented which justify the supervision and decision of this Court;

(2) There are no conflicts between circuits, as the petitioner here asserts; and

(3) The questions sought to be presented are without merit.

The Facts

The respondent Thatcher Manufacturing Company (hereinafter called "Thatcher") is a New York corporation, is engaged in the manufacture and sale of glass bottles and containers, with factories in Elmira and Olean, in the State of New York, and in Streator, Illinois, and in 1943 and 1944 also had factories in Long Island City and Lockport, New York (R. 95-96).

In 1943, when the option program was initiated, Thatcher's affairs were in an unsatisfactory condition and this was reflected in the stock market quotations of its common shares (R. 159). The price of the common stock had dropped from a high of 48⅞ and a low of 33⅞ in 1936, to a high of 9¼ and a low of 5 in 1942. In 1943 a low of 6¼ was reached. At the same time, in contrast to fairly substantial dividends on the common for the six years 1935-1940, no dividends at all had been paid in 1941, 1942 and 1943 (R. 159).

One Franklin B. Pollock was at the time Thatcher's New York Sales Manager under a five-year contract commencing January 1, 1942, under which he received in salary and commissions in 1942 $52,000, in 1943 $75,740 (R. 36, 96), and, had his contract been continued, his compensation in 1944 would have aggregated $88,758.20, and in 1945 $96,358.67 (R. 190).

Pollock had been with Thatcher's subsidiary, Olean Glass Company, from its inception in 1928 in various capacities, finally becoming Vice-President (R. 49). As the trial court pointed out, Pollock was not a newcomer to the situation and was the biggest money earner in the corporation (R. 85).

It was during this period of the corporation's failing fortunes that Pollock and some friends and relations

began in 1943 to acquire stock of Thatcher, Pollock himself buying 7,668 shares, and the total acquisitions of himself and these associates aggregating 35,000 shares (R. 50). (None of these associates acquired positions with the corporation nor did they become officers or directors (R. 68-69)).

Finally, on December 15, 1943 Pollock presented to the directors of the corporation a comprehensive program for its rehabilitation (R. 171-174), which involved changes in personnel (including his own election as President), the effecting of economies in the corporation's plants, the reorganization of its sales department, changes with respect to sales policies, a management bonus plan and a stock option plan for key executives.

In view of the petitioner's gratuitous statement that the Board of Directors "immediately surrendered the control of the corporation to Pollock" (Br. p. 8), we wish to emphasize the character of the personnel of the board.* It then consisted of eight directors, four elected by the preference stock (whose tenure of office could not be disturbed by any common stockholder such as Pollock) and four by the common stock.

Of these eight directors, one was President of an Elmira bank, one was Chairman of the board of another Elmira bank, one was President of an Elmira coal company, one was a member of a New York investment banking house, one was a retired President of Thatcher, one was General Counsel for Thatcher, one was the then President of Thatcher and one was the then Vice-President of Thatcher. With the exception of the then President of Thatcher, all of the directors were stockholders, six of

* The full detail with respect to the personnel of the directors will be found in tabulated form on p. 139 of the Record.

them holding substantial blocks. Moreover of these eight, two had been directors since 1913, one since 1916, one since 1922, one since 1927, one since 1936 and one since 1940.

That such a board would "surrender" the control of the corporation to Pollock is against reason or common sense. On the contrary it would be motivated to improve the corporation's situation.

This Board of Directors acted favorably upon Pollock's recommendations and at a subsequent meeting on December 22, 1943 authorized the option program in question.

As to Pollock the directors approved a new arrangement under which he would surrender his favorable employment contract and receive a salary of $50,000 a year for five years and options for common stock of 5,000 shares at $10.00 per share to be exercised on or before February 1, 1944, and 5,000 shares at $15.00 per share and 5,000 shares at $20.00 per share to be exercised on or before January 1, 1949. Like options were authorized in lesser amounts to four other key officials, *i.e.*, F. K. Rodewald, W. D. Dugan, George Dusterdieck and Whitney S. Powers (R. 176-178).

The situation with respect to these other four optionees was as follows (R. 65-68):

Rodewald had at one time been connected with Thatcher, but in 1943 was associated with Georgeson & Company at a salary of $12,000 a year, plus a percentage of the profits, and to induce him to return to Thatcher Pollock had suggested a salary of $18,000 a year and the options.

Dugan had been President of Olean Glass Company and later Vice-President of Thatcher and a director, and therefore had been Pollock's superior, whereas under Pollock's program, Pollock would become Dugan's

superior. Pollock persuaded him to stay with the corporation, not increasing his salary, but proposing the option arrangement as an inducement.

Dusterdieck had been Sales Manager for a number of years, and as an inducement to him to remain he was offered the Vice-Presidency in charge of sales and the options.

Powers had been Assistant Production Manager, but had indicated his purpose to leave the corporation. He was persuaded to stay and become its Secretary and Treasurer with an increase in salary and the options.

Put briefly, the situation was that the services of these four key officials were either obtained or retained by the new administration upon the inducement, among other things, of giving them the options in question.

In addition, it was contemplated that options would be granted to others than the five already mentioned, Pollock's entire program contemplating options on an aggregate of 39,260 shares (R. 180), and that there was an opportunity for everybody to participate in the fruits of their own work and efforts was generally made known throughout the corporation (R. 65). (Subsequently options were granted to thirteen other optionees, but, as has been stated, the petitioner stipulated upon the trial to withdraw his objections as to these thirteen additional optionees (R. 99-100)).

The basis of the determination of the minimum option price of $10.00 per share was logical and simple. The board fixed that minimum because it represented the average value of the stock as traded in on the New York Stock Exchange for the year 1943. The board discounted a rise in the price of the stock during the last quarter of 1943 because of the circumstance that the purchases by

Pollock and his associates in the very small market which existed had caused the quotations to rise about four points (R. 36-37).

There has never been any contention by the petitioner that the minimum of $10.00 per share was not an appropriate figure when decided upon in December of 1943. It has been the petitioner's contention that that figure should not have been retained when the options were formally granted in March of 1944, at which time the market price of the stock had risen to $19.00.

This brings us to what is really the gist of the case. What happened was that after the directors had decided to grant the options in question to the five designated optionees and such others as should be determined upon, and the new administration had come into office upon that basis, it developed that there was not enough available common stock to permit of carrying out the program. Consequently, the matter of options again came up at the next meeting of the directors on January 19, 1944 (R. 55) at which time it was determined to postpone the carrying out of the program in order to submit to the stockholders a proposal for the reclassification of the stock of the corporation to make available for the option program an additional 36,000 shares of common stock.

Had it not been for this technical difficulty, the options could have been granted immediately, and the directors felt that the program had to be proceeded with because, as stated by the respondent Mandeville (one of the directors and general counsel for the corporation), there was a definite commitment to these officers and employees "which except for the mechanical procedure of producing stock with which to fill the options would have been carried out immediately" (R. 75).

The trial court properly found that the carrying out of the option program was appropriate and necessary as a matter of recognizing the moral obligations incurred to the said several optionees in December, 1943 and therefore to preserve the morale of the corporation's organization (R. 100), and the Circuit Court of Appeals said (158 Fed. 2d 687, 693):

> "Whether to disappoint the just expectations of those on whom the corporation needed to rely during its upbuilding was a business problem for the directors to solve."

The matter of reclassifying the corporation's stock was thereupon proceeded with and the matter was submitted to the stockholders at their annual meeting held March 2, 1944. The notice of meeting and the proxy statement (R. 137-143) contain precise statements of the reclassification which was desired and of the purpose for which it was sought, including the proposal for options to Pollock and others, together with the prices and termination dates as to each price level, and there was likewise transmitted to the stockholders a proxy which permitted each stockholder to indicate whether he wished to vote for or against the proposed reclassification (R. 195-196).

At this meeting on March 2, 1944, the reclassification of stock was approved, 91,893 shares of preference and 106,648 shares of common stock voting in favor of the proposal and 3,998 shares of preference and 11,952 shares of common stock voting against the proposal (R. 149-152). In pursuance of this approval, the Certificate of Reclassification was thereupon filed on March 6, 1944 (R. 185).

The petitioner had been represented at the stockholders' meeting by counsel and had unsuccessfully sought an adjournment of the meeting. His counsel thereafter

wrote Thatcher a letter (R. 23-24) in which, however, he merely complained about the $10.00 option proposed to be given to Pollock and demanded that the corporation and its officers "take proper action to prevent the scheme to sell the stock to the president of the corporation at less than the real value."*

Thereafter, at a meeting of the Board of Directors on March 22, 1944, the options were formally approved, Pollock and Dugan (the only two director-optionees) not voting (R. 185-187).

At this time the market price of the common stock had risen to $19.00 per share (R. 100) but, as has been pointed out, the directors did not feel that they could repudiate the basis on which the new administration had been set up and refuse to grant the options at the prices fixed in December, 1943 when the option program had been presented as an inducement to the new administration.

As has been stated, both the trial court and the Circuit Court of Appeals found that the directors acted in good faith and for the best interests of the corporation and there certainly was substantial evidence to support these determinations.

However, the petitioner makes the contention that Pollock exercised his $10.00 option (which is not the fact) and at the same time in March, 1944 sold 2,468 shares at about $19.00 per share for a total of $44,913.50 (Br. pp. 12-13). The petitioner contends that on May 15, 1944 the board adopted a resolution releasing Pollock from his "liability" to the corporation for the difference between $19.00 per share which he received on the 2,468 shares, and the $10.00

* Nothing was said in the letter about the options at higher levels to Pollock or about the options to others and as it ultimately eventuated that Pollock took down no stock at $10.00, the present contentions were manifestly afterthoughts.

option price "which he had exercised at the same time under his option contracts", such asserted liability being in pursuance of Section 16 (b) of the Securities Exchange Act of 1934.

It is not disputed that Pollock had sold 2,468 of his shares which he acquired in the previous year. This was not a market speculation. It appeared without contradiction, and was so found by the trial court, that after Pollock became President in December, 1943 it was necessary for him to move to Elmira, New York (the home office of the corporation) for which reason he bought a house there for which he paid $21,000 and, at the same time, paid off a bank loan of $25,000 and income taxes of approximately $9,000, or a total of $55,000 (R. 42-43).

The trial court's finding was that Pollock had sold 2,468 shares of his stock for a total of $44,913.50 in order to satisfy personal obligations in excess of that amount (Finding 20, R. 100), and no error was assigned to this Finding (R. 107-108).

However, Pollock at no time had exercised his $10.00 option, but had permitted it to lapse. In consequence, the directors on May 15, 1944, after the option had lapsed, substituted a new option for 5,000 shares at $15.00 per share to be exercised on or before April 1, 1945 (R. 152-154). At the time this new option was granted, the stock had declined to 16¾ (R. 57). (Finding 20, R. 100.) Moreover, Pollock exercised this new option only as to 3,000 shares, doing so on March 31, 1945 when the market price was 14¾ (R. 47).

Whether or not Pollock originally intended to exercise the $10.00 option is beside the point. He never did so and there is therefore no substance whatever to petitioner's contention in that respect.

Petitioner also makes the contention (Br. p. 27) that the options were not conditioned upon employment and that each optionee could have exercised all of his options on one day and terminated his employment the next (Br. p. 27). This is not the fact in the case of Pollock who had a new contract for a fixed term (R. 145-148). As to the others, such contracts were not entered into as the setup obviously was experimental. However, all of the optionees are still with the corporation, except three of the thirteen eliminated by the petitioner (of those three, two were let out and one was pensioned after 37 years of employment with the corporation), and with the exception of Dugan, who was still with the corporation a year later and who exercised his option only for the $10.00 stock, and Dugan did not voluntarily leave, but his resignation was requested (R. 64).

On the subject of waste, the trial court made the following finding (Finding 26, R. 101):

> "There was no waste of the corporation's assets on the part of the Board of Directors in the granting of the said several options".

No error has been assigned as to this finding.

It is apparent that Pollock's proposal for a new management made to the directors in December, 1943 was fully justified by the aftermath as reflected in the appreciation of the market value of the stock, and that the incentive given the key executives of a participation in the ownership of the business proved to be, as the directors expected it would be, a material factor in the improvement which ensued.

Certainly there was substantial evidence upon which to predicate the determination of the trial court and no

question is presented to justify the consideration of this Court.

Argument

The petitioner assigns seven so-called reasons for the granting of the writ (Br. pp. 4-5) and we will discuss them in the order in which the petitioner sets them forth.

1. As to the petitioner's contention that this case presents important questions in corporation law involving fiduciary obligations of officers and directors.

As his first reason for the granting of the writ, the petitioner contends that this case presents important questions in corporation law involving fiduciary obligations of officers and directors, asserting that the opinion of the Circuit Court of Appeals in the case at bar is in conflict with the decision of the Sixth Circuit in the case of *Ashman* v. *Miller,* 101 Fed. 2d 85.

That case involved the question as to whether the purchase by corporate directors for their own benefit of voting trust certificates of the corporation was under such circumstances as to impose upon them the duty to act for the corporation.

No conflict can be found between the philosophy of that case (which does not quadrate upon the facts) and the philosophy of the instant case where the Circuit Court of Appeals said, at p. 692:

> "Of course the directors were fiduciaries who were bound to act at all times fairly and honestly for the best interest of the corporation and could not take advantage of their position as 'insiders' for their own personal gain. They had to see to it that the corporation should have the benefit of

> their best judgment and act solely and always in good faith to promote its welfare."

In the instant case, the Circuit Court of Appeals went on to point out that incentive compensation must bear a reasonable relation to the value of the services it is made to obtain, and then said at p. 692:

> "Such reasonable relationship is in the first instance an affair of business to be handled in the light of all the relevant circumstances in the exercise of the unbiased judgment of those in charge of the business itself."

The court then cited *Pollitz* v. *Wabash R. R. Co.,* 207 N. Y. 113, where it had been said of directors (p. 124):

> "Their corporate acts, within the powers of the corporation, in the lawful and legitimate furtherance of its purposes, in good faith and the exercise of an honest judgment, are valid and conclude the corporation and the stockholders. Questions of policy of management, expediency of contracts or action, adequacy of consideration, lawful appropriation of corporate funds to advance corporate interests, are left solely to their honest and unselfish decision, for their powers therein are without limitation and free from restraint, and the exercise of them for the common and general interests of the corporation may not be questioned, although the results show that what they did was unwise or inexpedient."

The directors, in formulating and proceeding with the option program were exercising the general discretion in them reposed; there was no fraud and in their opinion the options were for the best interests of the corporation.

Moreover, as we have said, the trial court's finding that there was *no waste* has not been assailed.

In this connection, we call to the Court's attention the careful consideration of the matter of options in *Diamond* v. *Davis,* 38 N. Y. S. 2d 103 (not officially reported; affirmed without opinion 265 App. Div. 919 and 292 N. Y. 552), which is peculiarly appropriate here. There it was said (p. 113):

> "Where the services are of value and are so recognized, in the absence of statutory provision or decision to the contrary, stockholders and directors acting in good faith may grant a bonus, or an option, to a valuable officer, by which a proprietary interest may be purchased by him or any employee so favored, at a price fixed in the agreement, as an incentive to retain his services, sharpen his interest, intensify his zeal, spur him on to more ardent effort in the interest and for the benefit of the company, and to enable him thereby to share in the resulting success of the enterprise."

This case manifestly presents no important question of corporation law which justifies the consideration of this Court.

2. As to the petitioner's contention that there is here directly involved the consideration of Rule 8(c) of the Federal Rules of Civil Procedure, requiring a defendant to plead specially matters in avoidance or justification, and as to certain miscellaneous contentions in the petitioner's brief.

The petitioner presents as a second basis for granting the writ that this case directly involves the consideration of Rule 8(c) of the Federal Rules of Civil Procedure,

which requires a defendant to plead affirmatively matters in avoidance or justification (Br. p. 4) and amplifies the contention at pages 15 and 16 of his brief.

This contention is here made for the first time in this litigation. It was not advanced to the trial court or to the Circuit Court of Appeals. Moreover, it is completely without merit.

It seems to be the petitioner's contention that the trial court first ruled that the granting of the options at $10 when the market price was $19 would normally constitute a constructive fraud upon the corporation, but then held that there was something else in the case to remove it from constructive fraud, i.e., that it had been found necessary to proceed with the option plan because of the understandings with the various officers and employees at the time the proposal originally was approved. The petitioner asserts that this justification of the affair was the sort of affirmative defense which should have been pleaded under Rule 8(c).

Not only did the petitioner not raise this point below, but the pleadings demonstrate that the Rule has no application to this case. Here the petitioner's complaint had charged that the granting of the options was contrary to equity and good conscience and operated as a fraud on the corporation and its stockholders who opposed it (R. 11), allegations which were denied in the answers (R. 28). Consequently, it was the petitioner who alleged fraud, which was denied by the respondents, and no affirmative defense whatever could be involved.

In this connection petitioner cites *Schmidtke* v. *Conesa*, 141 Fed. 2d 634, as holding contrary to the result here and therefore as creating a conflict of the circuits. That case has no application. It was a suit under the Fair Labor

Standards Act for unpaid overtime compensation. All that the court there held was that the plaintiff, in order to state a cause of action under the statute, was not required to allege that its exemptions were inapplicable to him, but that exemption was a matter which might be alleged as a special defense. That holding has no bearing upon a situation such as this, where the plaintiff charged fraud and the defendants' only duty was to negate the charge.

Petitioner further contends (Br. p. 17) that the evidence which was the foundation for this defense was inadmissible as it was based upon conversations between Pollock and the men whom he was engaging and was "clearly objectionable on the ground of the Hearsay Rule". At the trial the petitioner's counsel made the objection that at the time of his conversations with the then prospective executives Pollock was neither an officer nor a director of the corporation and that any conversations or dealings he had with them was not binding (R. 65-66). Nothing was there said expressly about the hearsay rule.

In any event, the rule is not applicable because the conversations were themselves the factum of the arrangements which were being made, and whether or not Pollock was then an officer or director became beside the point when his negotiations were acted upon and approved by the directors of the corporation.

Whether the testimony with respect to these arrangements was false, as the petitioner also asserts (Br. p. 18), is not here open for review, as the trial court's finding to the contrary was amply supported by the testimony which was not at any point contradicted.

As part of this same general discussion, the petitioner asserts that the reclassification of the stock for option purposes was procured by fraudulent means (Br. p. 19). Petitioner is talking particularly about the manner in which the matter was submitted to the stockholders. Yet the proxy statement (R. 137-143) fully advised that the effect of the adoption of the resolutions would be to make available 36,000 shares of common stock which it was contemplated the Board of Directors might from time to time and without further authorization of the stockholders issue and sell "to such officers and employees as determined by the directors", specifying the prices and the termination dates. The petitioner complains, however, that it was not disclosed who the optionees, other than Pollock, were to be, but it does not appear that the directors themselves knew until after March 2, 1944 who would comprise the full list of optionees. As to the option prices, the stockholders must be presumed to have known that on the day before the meeting the market price of the stock was 17-16½ (R. 65). The stockholders were fully apprised of all material features and, other than the petitioner, no stockholder ever has complained of the matter (R. 77).

The petitioner goes so far as to make the assertion (Br. p. 20) that in the proxy statement the stockholders were informed that no one owned more than 10% of the stock (R. 40), whereas it was concealed from the stockholders "that Pollock controlled over 20% of the stock". The statement contained in the proxy statement was precisely accurate and as called for by Regulation X-14 of the Securities and Exchange Commission under the Securities Exchange Act of 1934. Moreover, there is no evidence whatever that Pollock then "controlled over 20%

of the stock'' much less that he ever owned more than 10% of it.*

Nor of course is it material that the proxy statement set forth the proposal that the optionees could borrow 80% of the option price from the corporation (Br. p. 20), since, as stated in the petitioner's brief, no such program was carried out.

All of these contentions would seem to be resolved by the finding of the trial court that there was no fraud on the part of the directors in the granting of the said several options (Finding 25, R. 101). That finding certainly was not clearly erroneous and is therefore not open to review by an appellate court (Rule 52 of the Federal Rules of Civil Procedure).

3. As to the petitioner's contention that the affirmance of the judgment of the trial court with respect to the "release" of Pollock from his "admitted liability" is in conflict with the Fifth Circuit.

The petitioner next contends (Br. p. 4) that the affirmance of the judgment of the trial court that the directors had the power and acted in good faith when they released the president and director from his ''admitted liability'' for the profit of $8 per share on 2,468 shares which he sold in March, 1944 is in conflict with a decision of the Fifth Circuit. (*Hurt* v. *Cotton States Fertilizer Co.,* 159 Fed. 2d 252.)

There is nothing in this point because, as we have said (*supra,* p. 10), Pollock never exercised his $10 option,

* The proxy statement expressly called attention to the fact that in addition to his own holdings Pollock's immediate family beneficially owned 3,000 shares of common stock (R. 139, footnote 2).

and therefore was never under any obligation to the corporation under Section 16(b) of the Securities Exchange Act of 1934.

Moreover, the cited decision in the Fifth Circuit has nothing whatever to do with such a situation. That case was concerned with the propriety of the granting of retroactive compensation in the form of bonuses to themselves by directors, who were the holders of all of the common stock, as against the complaint of preferred stockholders.

4. As to the petitioner's contention that the decision, "to the effect that options to purchase stock may be granted to officers and directors without fixing the value of the stock and without restricting the right to transfer the stock conditioned on the term of employment", is in conflict with two decisions of the District Court in Pennsylvania.

This contention of the petitioner (Br. p. 4) is based upon a false assumption and upon a lack of understanding of the import of the two Pennsylvania decisions in question, i.e., *Holthusen* v. *Edward G. Budd Mfg. Co.*, 52 Fed. Supp. 125 and 53 Fed. Supp. 488.

The assertion that the options were granted without fixing the value of the stock is amplified by the petitioner at p. 26 of his brief, but is without substance. Mr. Mandeville, general counsel of the corporation, testified that the value was fixed by the board on December 22, 1943, and that it was based upon the average market value of the stock for the year 1943 (R. 36-37). This testimony was corroborated by that of Mr. Pollock (R. 55) and there was no contradiction.

The two *Holthusen decisions* are discussed by the petitioner at pp. 27-29 of his brief. In the first of these decisions the District Court disapproved of options where the optionees were not required to obligate themselves to remain in the corporation's employ. In the second decision the same judge approved of a later modified plan which provided for five year options, although the optionee was only required to remain in the corporation's employment for one year. The court in the second decision phrased the question as being "whether it appears that the value of the options does not bear a reasonable relation to the consideration to be received for them" (53 Fed. Supp. 488, 490).

In other words, it was the theory of the District Judge that the matter was one of a balancing of factors.

In the instant case, the Circuit Court of Appeals said (p. 693):

> "Some complaint has been made because the options could be exercised at any time after they were granted, though only while the optionees remained in the employ of the corporation, and that they were not conditioned upon any agreement by the optionees to remain employed for a definite period. Whether or not such a condition would have helped or hurt the incentive features of the arrangement and consequently been good or bad for the corporation was also a business problem for the directors to solve. Having acted honestly in that regard, the result of their best judgment is binding upon the corporation and its stockholders."

The petitioner's position is, to say the least, inconsistent, since upon the trial he withdrew his objection to thirteen of the eighteen options, none of which contained anything binding as to the term of employment.

Whether here the optionees were to be obligated to work for the corporation for any particular length of time, or for no length of time, was obviously in the discretion of the board of directors. It is to be borne in mind that the directors were dealing with a situation where a new administration was replacing the old administration, and where there were a number of changes in the top personnel. It was the desire of the directors in creating this new setup to give the key men options as incentives to produce the best possible results, but the setup necessarily was experimental and it might well turn out, as it did in the case of Dugan, that some of the personnel, although able, would not fit into the picture as it had been hoped they would. In this situation it would not be to the interest of the corporation to tie itself up to term contracts with all of these optionees, and it was definitely to the interest of the corporation to give them some incentive, which at the time the plan was proposed presented no immediate substantial market advantage. In view of the trial court's unchallenged finding that there was no waste, the appellant's comments on this subject can have no substance.

The fact of the matter is that the entire option plan turned out to be of the utmost benefit to Thatcher and no one of Thatcher's numerous stockholders has complained of it, except the plaintiff, and he at the time complained only of the $10 option to Pollock which was cancelled. The following language from the second *Holthusen* opinion is here most appropriate (53 Fed. Supp. 488, 490):

> "The burden is on a minority stockholder of a corporation who seeks to have the courts intervene in corporate management and restrain action approved by the board of directors, to establish that

such action transcends the point where the will of the majority may properly be imposed on the minority. Unless this be so, the floodgates would be opened to a surge of litigation by which the courts would be called upon to review the action of corporate directors with respect to all contracts of employment and an unlimited number of other matters."

5, 6 and 7. As to the petitioner's contention that there have here been decided important questions in the field of corporate law and trusts in conflict with fundamental law.

The petitioner's reasons numbered 5, 6 and 7 cover substantially the same ground and the general import is as above stated (Br. p. 5).

Number 5 purports to have to do with the question as to whether the directors may grant stock options to "insiders" at one-half of the market price because of alleged commitments made before the advance of the market price.

This, of course, merely restates the problem which faced the directors of Thatcher, which was simply whether to disrupt the morale of the new administration by refusing to carry out promises made simply because of mechanical difficulties encountered in their consummation. As to this the Circuit Court of Appeals properly said (p. 693):

> "Whether to disappoint the just expectations of those on whom the corporation needed to rely during its upbuilding was a business problem for the directors to solve."

Number 6 is simply a rephrasing of number 5 with an emphasis on the options to Dugan, as to whom petitioner states "no commitment was made." This statement as to Dugan flies directly in the face of the uncontradicted

testimony in the case to which we have referred above (p. 5).

Number 7 makes the gratuitous statement that the Circuit Court of Appeals "has decided important questions in the field of corporate law and trusts in conflict with fundamental law and the questions are of great public interest."

There was nothing in the decision of the Circuit Court of Appeals or of the trial court which departed from the long settled principles enunciated in *Pollitz* v. *Wabash R.R. Co.,* 207 N. Y. 113, 124 (*supra,* p. 13), where the court said that questions of policy of management, expediency of contracts or action, adequacy of consideration, lawful appropriation of corporate funds to advance corporate interests, are left solely to the honest and unselfish decision of the directors.

CONCLUSION

The petition for a writ of certiorari should be denied.

Dated: New York, N. Y., April 28, 1947.

Respectfully submitted,

EDWARD K. HANLON,
15 Broad Street,
New York 5, N. Y.

A. H. HARPENDING,
521 Robinson Building,
Elmira, New York.
Attorneys for Respondents.